November 9, 2012

The Honorable Pete Lund and Members of the House Insurance Committee
State of Michigan
State Capitol Building
Lansing MI 48909

Re: Blue Cross Blue Shield of Michigan Conversion

Dear Chair Lund and Committee Members:

We are writing to express our concerns on Senate Bills 1293 and 1294 regarding the proposed conversion of Blue Cross Blue Shield of Michigan (BCBSM) from a public charitable organization into a nonprofit mutual insurer and offer five recommendations. We thank you for your consideration of these recommendations and urge you to work with your colleagues in the Legislature and the Governor to insure that Michiganders are the ultimate beneficiaries.

First, in any conversion of a public charitable organization into a non-charitable organization, the net worth of the entity must be captured and remain dedicated to charitable purposes, typically by being transferred to a charitable foundation. The proponents of the legislation argue that an independent appraisal is not required. They assert that BCBSM's proposal to contribute $1.5 billion over 18 years is fair because it amounts to roughly half of the company's reserves. However, the legislation does not require that BCBSM transfer $1.5 billion to the Michigan Health and Wellness Foundation. Instead, SB 1294 at Section 220(2)(A) provides that BCBSM shall "use its best efforts to make annual social mission contributions in an aggregate amount of up to $1,500,000,000.00 over a period of up to 18 years beginning in April 2014 to the Michigan Health and Wellness Foundation . . . ." Thus, if BCBSM determines that using its best efforts it can only make contributions of $1 million per year and in some years no contributions, the legislation provides no recourse to the State of Michigan.

If this is intended to be a good will gesture by BCBSM to set aside a reasonable amount for charitable purposes over an 18 year period, **we recommend** that the legislation set a minimum and certainly not a maximum amount. Simply stating "Best Efforts" is not sufficient.

Second, proponents of the legislation argue that BCBSM is converting from one type of nonprofit to another, a "nonprofit mutual disability insurer." The proposed legislation adopts the new term "nonprofit mutual disability insurer" and provides that a domestic mutual insurer may be formed with nonprofit status.

A nonprofit mutual disability insurer will have all the powers of a mutual insurer organized under the statute unless expressly reserved. However, nothing in the statute describes what it means to be a mutual insurer with "nonprofit status." The potential for BCBSM management to personally profit at the expense of the organization is a major concern.

The Michigan Nonprofit Corporation Act at Section 108(2) states that a "nonprofit corporation" means "a corporation incorporated to carry out any lawful purpose or purposes not involving pecuniary profit or gain for its directors, officers, shareholders or members." Taken literally, this would mean that the new BCBSM could not be operated on a for-profit basis nor could its directors or officers profit or gain from their participation other than presumably receiving reasonable compensation for reasonable services performed. The difficulty we have in Michigan is that there is no regulatory authority charged with overseeing this requirement. At a minimum, **we recommend** that the proposed bills be amended to provide that the Michigan Attorney General be given the supervisory authority to enforce this provision under Michigan law.

Third, the proposed legislation requires the Michigan Health and Wellness Foundation to help subsidize Medigap premiums for seniors for five additional years from 2016 to 2020. We believe this notion is ill-conceived given the Foundation's intention of securing Section 501(c)(3) status under the Internal Revenue Code. If one of the Foundation's purposes is to keep Medigap rates low and BCBSM is a substantial provider of Medigap coverage, providing the subsidy will indirectly benefit BCBSM. Since virtually all funding for the Foundation will come from BCBSM, it will be classified as "disqualified person" under federal tax law.

One could argue that the subsidy, in fact, would allow BCBSM to charge higher rates than it otherwise could. That presents a self-dealing and/or private inurement violation under federal tax law. Granted, the IRS generally considers seniors and those in need of healthcare to be charitable classes, per se. However, the lack of disinterested donors and the use of charitable funds for indirect private benefit would outweigh the charitable aspects of this program. Accordingly, we would not expect the IRS to grant Section 501(c)(3) status to the Foundation. Thus, the proposed structure of the transaction has a serious flaw under federal tax law.

We recommend that the Medigap subsidy provisions in the law be eliminated and replaced with a requirement that 60% of foundation disbursements be used to support healthcare concerns of needy seniors and Medicare enrollees.

Fourth, the proponents of the legislation would have us believe that the Michigan Health and Wellness Foundation will be an independent charitable foundation outside the control of BCBSM. The bill prevents an employee of an insurance carrier, producer, healthcare provider, third party administrator or one of their affiliates or subsidiaries from serving on the board of the foundation. However, the bill provides legislative leadership with considerable influence into the composition of the board. It gives the Governor the authority to appoint the members of the board with the advice and consent of the Senate; however, two members must be chosen from individuals nominated by the Senate Majority Leader; two members from individuals recommended by the Speaker of the House of Representatives; one member from nominees recommended by the House Minority Leader; and one member from individuals recommended by the Senate Minority Leader.

Please note that this would not prevent one or more lobbyists for BCBSM from being nominated to serve on the board by the legislative leadership. Furthermore, the bill would not prevent BCBSM board members from serving on the foundation board. It is quite conceivable that BCBSM management, through its influence with the legislature could exert significant ongoing control over the board of the foundation.

We recommend that the legislation be revised to allow the Governor to appoint the initial board only and then allow the board to be self-perpetuating. Virtually all independent private and community

foundations in Michigan have self-perpetuating boards which are representative of the general public. In this way, undue influence over the foundation by BCBSM management can be better managed and avoided.

Fifth, notwithstanding the widespread assumption that the Michigan Health and Wellness Foundation will be seeking Section 501(c)(3) status from the IRS, there is nothing in the proposed legislation that requires the foundation to be organized for charitable purposes. In fact, the Senate bills appear to have been carefully crafted to avoid any references to charitable purposes and/or Code Section 501(c)(3). Section 653(1) provides that the foundation will be organized to receive and administer funds "for the public welfare." Section 653(2) lists nine specific purposes or programs that the foundation will conduct and, again, no reference to charitable activities or Section 501(c)(3).

We believe the legislation is intended to give sufficient flexibility to allow the foundation to be established as a civic or social welfare organization under Section 501(c)(4) of the Internal Revenue Code. Under federal law, Section 501(c)(4) organizations are permitted to lobby and even make contributions to candidates for public office.

Earlier this year, the IRS began subjecting organizations applying for Section 501(c)(4) status to additional, detailed scrutiny during the application process. Last year, the IRS focused its attention on major donors to politically active Section 501(c)(4) organizations.

The U.S. Supreme Court, in its 2010 landmark opinion, Citizens United v. Federal Election Commission, 558 US 50 (2010), paved the way for corporations to spend unrestricted amounts on independently produced and distributed ads that expressly urged the election or defeat of candidates for public office, known as "independent expenditures." Following this decision, many nonprofit corporations claiming exemption under Section 501(c)(4) were created and began raising and spending millions of dollars to influence the 2010 congressional elections. This year, Section 501(c)(4) organizations have been extremely active in political campaigns at the local, state and federal levels.

We recommend that the proposed legislation be amended to require the foundation to obtain status as a charitable organization under Section 501(c)(3) of the Code. This will prevent the foundation from engaging in unlimited public issue advocacy, specific legislative advocacy and engaging in political activities on behalf of or in opposition to candidates for public office.

The Council of Michigan Foundations (CMF) on behalf of our 350 members frequently serves as a partner with state and federal policymakers to strengthen the charitable nonprofit sector in Michigan. The legislation now under consideration presents major concerns in our shared goal to insure that the charitable assets of the State of Michigan are protected.

Sincerely,

Robert S. Collier
President

cc: Governor Rick Snyder